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Grasping the significance

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numbers which exist. The ratios must be based on relationships of fact. The data which portray must be accurate.

Two reports recently examined were the subject of criticism. One was filled with dry description of verification procedure not at all to the point of the engagement. The other was statisticized to the last degree, but the engagement failed to discover a shortage.

The first engagement was an examination for the purpose of obtaining additional capital. The report, as should have been anticipated after completing the engagement, even if all sense of imagination had been lacking up to that point, was to go to investment bankers. On the report was to rest a decision as to whether or not the bankers would undertake a flotation in behalf of the company; if so, what the amount and specifications of the issue should be.

The report should have contained a conservatively sound balance sheet, a statement of income and profit and loss by years running back from three to five years, stepped down in the income charge group to show the remainder of income successively after taxes, interest and depreciation, an estimate of the amount of capital required to put the company in a sound current and fixed financial position and provide for working needs for a reasonable length of time, suggestions as to the kind of securities considered most desirable, and all data which would be needed by the investment bankers in preparing a prospectus or offering sheet.

Whether the cash was verified by inspec-

tion or examination of branch office cash reports was inconsequential to either the client or the bankers. Pages, however, were taken to explain such minutia of procedure while information for use in arriving at conclusions as a basis for action was almost entirely lacking.

The second report in question should have set forth the fact that a cash shortage of some \$8,000 existed at a certain date, with such fact supported by information which would serve to produce evidence for prosecution of the guilty employe, or for recovery from a bonding company.

The purpose of the engagement was to discover any irregularity, or "leakage," as the client described it. Statistics of "Mark up" and "Mark down," of income charges in relation to net sales have no immediate significance for the client when he is concerned in apprehending an employe who is guilty of irregularities.

So engrossed was the accountant in the compilation of statistics that he failed to make a few simple calculations from the figures on the books which would have developed the shortage even if he had not put into practice the usual methods of detecting irregularities. This case was not an audit. It was an investigation. As such it should have revealed the shortage within half an hour after the preliminary statements had been prepared.

Statistics must represent numbers which exist. Ratios must be based on relationships of fact. Data which portray must be accurate. More illuminating reports are desirable. But the light must be shed on truth.

Grasping the Significance

FINANCIAL statements have attained a standing which no longer requires discussion as to their place and purpose. They are by force of circumstances technical. They deal with the status and use of

business capital, or of funds, which serve as the medium for the transaction of business. Through their large and frequent use they have become generally familiar to those who have occasion to consult and use

them. Balance sheets and income statements appear frequently in the daily papers, in published reports of corporations, in circulars offering securities for investment, and in manuals of statistical companies reporting on corporations, etc. They become a necessary part of business memoranda in furnishing valuable information to management, in serving as an index to efficiency, and as a guide to policy-making.

The true significance of the information contained in financial statements is still far from apparent. Differing and often conflicting opinions as to form have occupied the attention to the detriment of analysis, study, and interpretation. It is generally admitted that a current position should show at least two dollars of current assets for every dollar of current liabilities. It is frequently stated that an enterprise should maintain a proper balance between owned and borrowed capital; that there should be a proper relation between current and fixed assets. But why is a two for one current ratio desirable? What is the meaning if a balance sheet does not meet this requirement? What constitutes proper balance between owned and borrowed capital? Who can say what should be the relation between current and fixed assets? With respect to the operating needs and probabilities, what constitutes too little, or too much, or a proper amount of working capital? How much fixed capital can the

enterprise stand; or, in other words, what is the limit beyond which it would not be safe to go in the matter of plant property investment?

It is true that some standards have been set up whereby to compare the condition of a given enterprise. There is cause for great rejoicing that so much progress in this respect has been made, but the meat of the cocoanut, so to speak, has not yet been reached. Not until more intelligent thought and study are given to the significance of the various aspects of financial condition and relation of operations thereto will it be possible to interpret financial statements and make the data serve as a guide to the future. Past performance is only of value as it points the way to events which may follow. It is not sufficient to conclude that some condition is abnormal. If it is wrong in principle or dangerous in tendency, the way must be found to correct the condition. Proper correction may only come from a thorough understanding of the underlying causes.

The true significance, or in other words the meaning of balance sheets and income statements, may only be grasped, so far as an individual is concerned, by constant analysis and study. The subject is too deep to be easily expounded or thoroughly understood from reading about it. There is no "royal road." Anyone who would thoroughly understand financial statements must work, think, and persevere.

Mr. Dunn Remains

IN the January, 1921, number of the BULLETIN we announced with regret Mr. Dunn's avowed intention to retire from practice on June 1, 1924. With the changes which time has wrought in the organization since the announcement was made it has become increasingly apparent that such retirement would impose a loss difficult to repair. We are now able to

announce with pleasure that Mr. Dunn has been prevailed upon to remain in the firm in the capacity of counsellor and adviser, with freedom to pursue such out-of-door activities as he feels the necessity of doing. Needless to say his sound judgment and wise counsel will materially lighten the burdens of those who have the responsibilities of administration.